EXAMINATION REPORT
of
CAPITALCARE, INC.
Owings Mills, Maryland
as of
December 31, 2008

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

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I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of CapitalCare, Inc. as of December 31, 2008, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed to the original the seal of the Bureau at the City of Richmond, Virginia this 23rd day of November, 2009

Alfred W. Gross

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
August 13, 2009

Honorable Alfred W. Gross
Commissioner of Insurance
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by the authority of Section 38.2-4315 of the Code of Virginia, an examination of the records and affairs of

CAPITALCARE, INC.

Owings Mills, Maryland

hereinafter referred to as the Corporation, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Corporation became licensed in Virginia as a health maintenance organization ("HMO") pursuant to Chapter 43 of Title 38.2 of the Code of Virginia on March 4, 2002. The Corporation was last examined by representatives from the State Corporation Commission's (the "Commission") Bureau of Insurance (the "Bureau") as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2008.

HISTORY

The Corporation was incorporated in the Commonwealth of Virginia on July 26, 2001. The Corporation was organized as a wholly-owned subsidiary of CareFirst BlueChoice, Inc. ("CareFirst").

CAPITAL AND SURPLUS

At December 31, 2008, the Corporation's capital and surplus was $3,098,589. According to the Articles of Incorporation, the Corporation has the authority to issue 25,000 shares of common stock with a par value of $1 per share. At December 31, 2008, 1,000 shares of common stock were issued and outstanding, with paid in surplus of $4,499,000, and unassigned funds of ($1,401,411).

NET WORTH REQUIREMENT

Section 38.2-4302 of the Code of Virginia states that a HMO licensed in Virginia shall maintain a minimum net worth in an amount at least equal to the sum of uncovered expenses, but not less than $600,000, up to a maximum of $4,000,000. 14 VAC 5-210-60 A requires that an HMO report the sum of its uncovered expenses for each three-month period ending December 31, March 31, June 30 or September 30. Because the sum of the Corporation's uncovered expenses for the three-month period ending December 31, 2008 was $132,541, the Corporation's minimum net worth requirement at December 31, 2008 was $600,000.

MANAGEMENT AND CONTROL

The bylaws of the Corporation provide that the Board of Directors shall be responsible for the business and affairs of the Corporation. The Board shall consist of not less than three and no more than nine Directors. The Directors shall be elected each year at the annual meeting of the shareholders. A majority of the Board of Directors shall constitute a quorum for the transaction of business.

The officers of the Corporation shall consist of a Chairman of the Board, a President, a Secretary and a Treasurer. The bylaws also provide that the Board of Directors may appoint such other officers as it deems advisable.

At December 31, 2008, the Board of Directors and Officers were as follows:

Directors	Principal Occupation
Gregory M. Chaney	Executive Vice President & Chief Financial Officer CareFirst BlueCross BlueShield Owings Mills, Maryland
Gregory A. Devou	Executive Vice President & Chief Marketing Officer CareFirst BlueCross BlueShield Owings Mills, Maryland

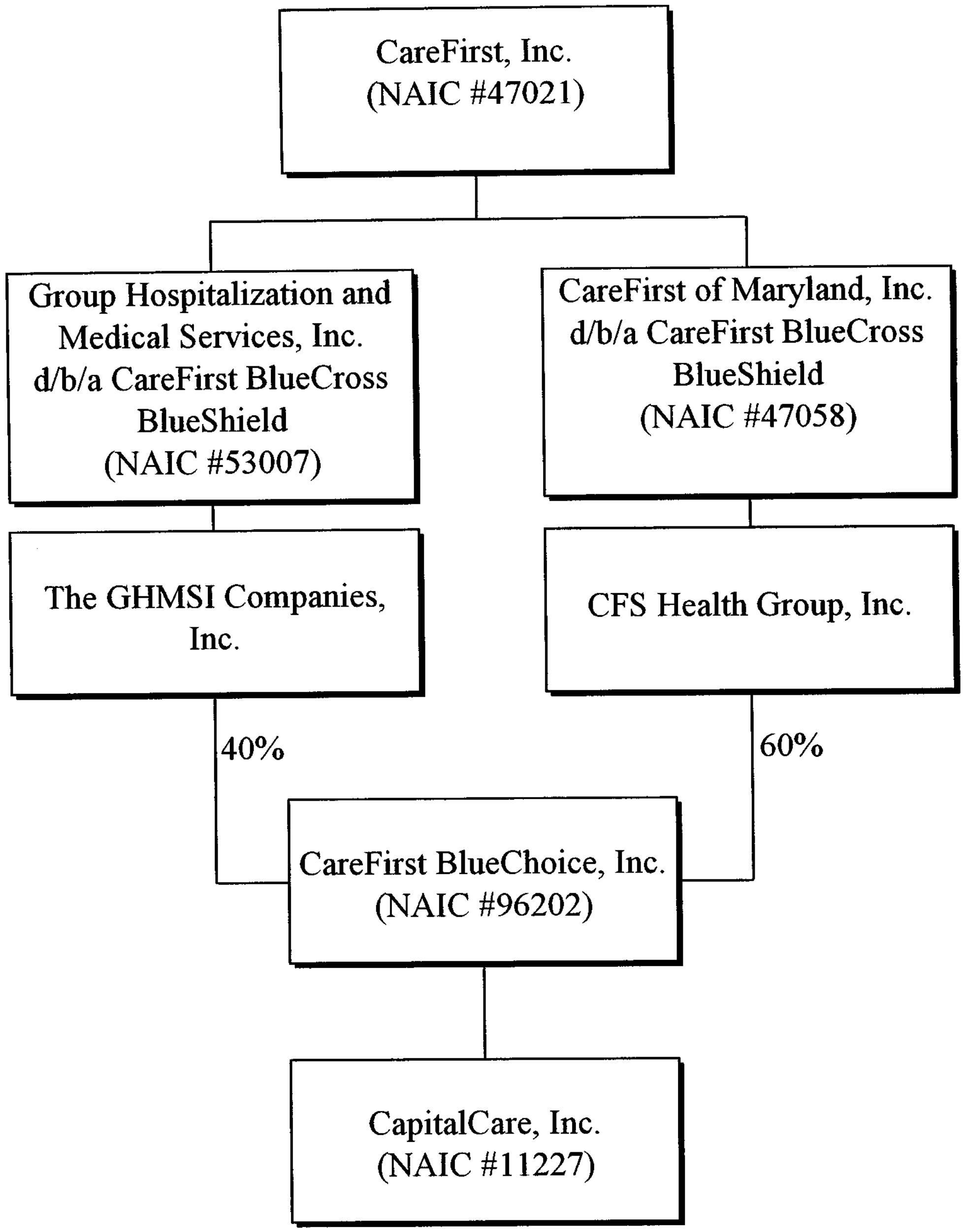
Teresa G. Harrison	Retired Columbia, Maryland
John E. Herold	Project Manager Mayor's Office of Information Technology Baltimore, Maryland
Robert I. Jeffrey	Senior Vice President – Wealth Management Smith Barney Baltimore, Maryland
John A. Picciotto	Executive Vice President & General Counsel CareFirst BlueCross BlueShield Owings Mills, Maryland
Jon P. Shematek, M.D.	Executive Vice President & Chief Medical Officer CareFirst BlueCross BlueShield Owings Mills, Maryland
David D. Wolf	Executive Vice President, Medical Management & Strategic Planning CareFirst BlueCross BlueShield Owings Mills, Maryland

Officers

David D. Wolf	Chairman of the Board
Jon P. Shematek	President
Lisa M. Myers	Secretary
Jeanne A. Kennedy	Treasurer
Joseph Petralia	Assistant Secretary

AFFILIATED COMPANIES

According to its Articles of Incorporation, the Corporation has the authority to issue 25,000 shares of common stock. At December 31, 2008, 1,000 shares were issued and outstanding and were owned by CareFirst. The chart on the following page illustrates the organizational structure of the Corporation and selected affiliated entities at December 31, 2008:


CareFirst, Inc.
(NAIC #47021)
Group Hospitalization and Medical Services, Inc. d/b/a CareFirst BlueCross BlueShield
(NAIC #53007)
CareFirst of Maryland, Inc. d/b/a CareFirst BlueCross BlueShield
(NAIC #47058)
The GHMSI Companies, Inc.
CFS Health Group, Inc.
40%
60%
CareFirst BlueChoice, Inc.
(NAIC #96202)
CapitalCare, Inc.
(NAIC #11227)

TRANSACTIONS WITH AFFILIATES

Administrative Services Agreement

Effective November 1, 2001, the Corporation entered into an Administrative Services Agreement with CareFirst and Group Hospitalization and Medical Services, Inc. ("GHMSI"). Under the terms of the agreement, GHMSI shall provide the following services:

a. Management Information Systems. Provide computer hardware, software, peripheral equipment and storage media needed to support the Corporation's operations.

b. Staffing and Employment Services. Provide all staffing for the Corporation including senior personnel.

c. Office Space and Support Services. Provide office space and parking facilities to support the Corporation's operations.

d. Accounting and Finance Services. Oversee the preparation and management review of the Corporation's financial statements, process and pay the Corporation's trade accounts payable, provide billing, accounts receivable maintenance and collection services, oversee the investment of the Corporation's surplus funds, provide actuarial and underwriting services and provide budgeting and financial planning functions.

e. Other Services. Provide other services, as requested by the Corporation, including, but not limited to, claims processing and customer service, utilization management and review, provider network administration and provider relations, sales, marketing and public relations, legal and legislative support, human resources and document storage and retention.

In return for providing the services, the Corporation shall reimburse GHMSI all direct costs and indirect allocable costs related to the administration of the Corporation's products. During 2008, the Corporation incurred $170,000 in administrative fees related to this agreement.

Stop Loss Insurance Contract

Effective July 1, 2002, the Corporation entered into a Stop Loss Insurance Contract with GHMSI. Effective July 1, 2004, terms of the contract were amended to include CareFirst of Maryland, Inc. ("CareFirst MD") as reinsurer with GHMSI.

According to the terms of the amended contract, a fund will be created in which the Corporation is charged a per member per month stop loss premium. Covered medical claims incurred in a contract year and paid during the contract year or within three months of the end of the contract year in excess of $100,000 per member are netted against the stop loss premium. If, at the end of the contract year, the fund balance is negative (i.e., incurred and paid claims greater than $100,000 per member are more than the stop loss premium), then CareFirst MD (60%) and GHMSI (40%) will reimburse the Corporation for the amount of the negative fund balance. If the fund balance is positive (i.e., incurred and paid claims greater than $100,000 per member are less than the stop loss premium), the Corporation receives no reimbursement from CareFirst MD or GHMSI and the stop loss premium for the contract year is capped at $25,000. The contract includes a continuation of coverage clause and a benefits conversion clause in the event of the Corporation's insolvency. During 2008, the Corporation incurred $64,000 in premiums related to this contract.

Tax Sharing Agreement

The Corporation entered into a Tax Sharing Agreement with and among Carefirst, Inc. and its affiliates effective September 21, 2007. Pursuant to the agreement, the Corporation is included in the consolidated federal income tax return filed by CareFirst, Inc. The Corporation's federal income tax liability or refund is determined as if it was filing its own separate federal income tax return. If the Corporation's tax benefits (i.e. losses or credits) are used to reduce the consolidated federal tax liability, CareFirst, Inc. will pay the Corporation the amount equal to the reduction in the consolidated federal income tax liability. If the Corporation's tax liabilities are used to increase the consolidated federal tax liability, the Corporation will pay CareFirst, Inc. the amount equal to the increase in the consolidated federal income tax liability.

TERRITORY AND PLAN OF OPERATION

At December 31, 2008, the Corporation's service area, as reported in its 2008 Annual Statement, included the counties of Arlington, Warren, Clarke, Fairfax, Prince William, Loudoun, Frederick, Rappahannock, Culpeper, Fauquier, Spotsylvania, Stafford, King George and Caroline.

Medical services are provided by physicians in independent practice within the Corporation's service area. Each member must choose a primary care physician ("PCP") from a list of the Corporation's primary providers. The Corporation offers members two options, CapitalCare and CapitalCare Advantage, when receiving health care:

1. CapitalCare. The member's PCP coordinates all health care needs. Except in emergencies, a member must obtain services only from, or prearranged by, their PCP. Specialty physicians are available only with a referral from a PCP. All hospital admissions must be arranged by the PCP and approved in advance by the Corporation.

2. CapitalCare Advantage. Members may receive benefits from an in-network component or an out-of-network component. The in-network component operates similarly to the CapitalCare option and offers a higher level of benefits than the out-of-network component. Under the out-of-network component, a member may elect to receive services from a non-participating provider of the member's choice or seek services from participating providers without a referral from their PCP.

Marketing efforts are provided by GHMSI through the Administrative Services Agreement. Enrollment of members is directed toward group coverage. Individual coverage is not offered except for conversion upon termination from the group coverage.

CONFLICTS OF INTEREST

The Corporation has adopted a code of business conduct applicable to its officers and employees. The code of business conduct relating to conflicts of interest states that officers and employees should avoid any activity or action that would result in an actual or perceived personal gain or advantage, in a third party obtaining an improper gain or advantage or in any other adverse effect on the Corporation's interest. To ensure compliance with the Corporation's code of business conduct, officers and employees must complete an annual conflict of interest questionnaire that discloses any interests, affiliations and relationships.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2008, the Corporation was listed as a named insured on CareFirst. Inc.'s fidelity and electronic crime policy with a $5,000,000 limit of liability, subject to a $100,000 deductible. In addition, the Corporation was listed as a named insured on a property insurance policy, a flood insurance policy, a general liability policy, an umbrella policy, an excess casualty policy, a business auto policy, a non-owned aviation policy, a pollution legal liability policy, a workers' compensation policy, a fiduciary policy, a director's and officers liability policy, an errors and omissions policy, a managed care anti-trust policy, an employers managed care policy, an employment practices policy and an e-commerce policy.

PROVIDER AGREEMENTS

Medical Services

The Corporation has entered into agreements with numerous PCPs and specialist physicians to provide or arrange for the provision of covered health care services to members. Covered health care services are those defined in the health care contracts and which are rendered in accordance with the guidelines set forth in such contracts.

The Corporation compensates participating physicians on a fee-for-service basis based upon a schedule of allowed charges established by the Corporation. The Corporation has established capitation arrangements for vision, mental health and laboratory services.

Hospital Care

The Corporation has entered into agreements with a number of hospitals in its service area to provide covered hospital services to members. Charges for services rendered to members are based in accordance with compensation schedules attached to each individual agreement.

Other Health Care Services

The Corporation has entered into various ancillary service agreements. These agreements include home health services, physical therapy, pharmaceutical services and durable medical equipment. Compensation is based on arrangements set forth in each agreement.

CONTRACT FORMS

The group enrollment agreement covers the following services provided by PCPs, participating specialists and other professional providers:

Covered Inpatient Hospital Services

1. Room and board in a semi-private room.
2. Inpatient physician and medical services.
3. Related inpatient services and supplies ordinarily furnished by the hospital to its patients.

Covered Outpatient Medical Services

1. Medical services and surgery.
2. Diagnostic procedures, lab tests and x-ray services.
3. Health exams and other services for the prevention and detection of disease.
4. Immunizations in accordance with accepted medical practice.
5. Allergy testing and treatment.
6. Obstetrical/gynecological services.
7. Well-child care and pediatric services.
8. Eye examinations, including annual refractions.
9. Hearing screening for children under 18.
10. Short-term rehabilitation services and physical therapy.
11. Radiation therapy and chemotherapy.
12. Family planning services.

Other services provided include skilled nursing facility services, home health services, hospice care services, mental health and substance abuse services, emergency care and out-of-area coverage.

Exclusions generally include services not considered medically necessary, experimental procedures, care provided by non-participating physicians, routine foot care, dental services, cosmetic services, artificial aids and corrective devices, durable medical equipment, and any service, supply or procedure which is not specifically listed in the group enrollment agreement as a covered benefit.

The above are abbreviated descriptions of the coverages and exclusions and each individual contract may vary.

GROWTH OF THE CORPORATION

The following data represents the growth of the Corporation, at year-end, from its inception in 2002 to December 31, 2008. The data is compiled from the Corporation's filed Annual Statements, the previous examination report, and the current examination report.

Year	Total Admitted Assets	Total Liabilities	Total Capital and Surplus
2002	$3,263,683	$1,661,592	$1,602,091
2003	4,024,708	1,416,250	2,608,458
2004	3,712,423	1,283,704	2,428,719
2005	3,397,436	1,030,969	2,366,467
2006	3,239,190	543,107	2,696,083
2007	2,889,564	484,887	2,404,677
2008	4,396,565	1,297,976	3,098,589

Year	Total Revenue	Net Investment Gains	Medical & Hospital Expenses	Administrative Expenses	Pre-Tax Income (Loss)
2002	$5,141,133	$68,228	$4,802,831	$251,474	$155,056
2003	5,793,864	207,905	5,235,271	797,463	(30,965)
2004	4,009,401	170,529	3,625,390	786,344	(231,804)
2005	4,062,523	142,283	3,721,083	543,733	(60,010)
2006	3,702,078	153,398	2,970,673	474,629	410,174
2007	2,692,561	136,001	2,840,414	348,601	(360,453)
2008	1,405,753	92,594	2,542,110	244,612	(1,288,375)

The Corporation's enrollment data at year-end is illustrated as follows:

Year	Number of Members
2002	3,720
2003	2,676
2004	1,594
2005	1,207
2006	999
2007	591
2008	421

SPECIAL RESERVES AND DEPOSITS

At December 31, 2008, the Bureau required that the Corporation maintain a $500,000 minimum deposit with the Treasurer of Virginia.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2006 through December 31, 2008. Assets were verified and liabilities were established at December 31, 2008. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet for which Specific Risk Analyses (SRA) were required had medium or low risk assessments as determined from the National Association of Insurance Commissioners Examiners Handbook. Analytical review procedures were applied for non-SRA items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report.

History
Corporate Records
Management and Control
Transactions with Affiliates
Territory and Plan of Operation
Conflicts of Interest
Fidelity Bond and Other Insurance
Provider Agreements
Contract Forms
Special Reserves and Deposits
Accounts and Records
Financial Statements

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2008; a statement of revenue and expenses for the year ending December 31, 2008; a reconciliation of capital and surplus for the period under review; a statement of cash flow for the year ending December 31, 2008; and a statement of Examiners' changes in capital and surplus at December 31, 2008. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$1,453,010		$1,453,010
Cash and short-term investments	2,925,306		2,925,306
Subtotals, cash and invested assets	$4,378,316	$0	$4,378,316
Investment income due and accrued	12,492		12,492
Uncollected premiums and agents' balances in the course of collection	31,340		31,340
Amounts recoverable from reinsurers	60,535		60,535
Current federal income tax recoverable	148,513		148,513
Net deferred tax asset	301,209	301,209	0
Receivables from parent, subsidiaries and affiliates	9,205		9,205
Health care and other amounts receivable	14,742	1,177	13,565
Total assets	$4,956,352	$302,386	$4,653,966
Deduct category 2 investments in excess of amount allowed by § 38.2-1403 of the Code of Virginia			257,401
Total admitted assets			$4,396,565

LIABILITIES, CAPITAL AND SURPLUS

	Covered	Uncovered	Total
Claims unpaid	$340,514	$34,246	$374,760
Unpaid claims adjustment expenses	12,721	1,279	14,000
Aggregate health policy reserves	810,000		810,000
Premiums received in advance		76,750	76,750
General expenses due or accrued		4,648	4,648
Ceded reinsurance premiums payable		4,327	4,327
Aggregate write-ins for other liabilities		13,491	13,491
Total liabilities	$1,163,235	$134,741	$1,297,976
Common capital stock			$1,000
Gross paid in and contributed surplus			4,499,000
Unassigned funds (surplus)			(1,401,411)
Total capital and surplus			$3,098,589
Total liabilities, capital and surplus			$4,396,565

STATEMENT OF REVENUE AND EXPENSES

	Uncovered	Total
Net premium income	XXX	$2,215,753
Aggregate write-ins for other health care related revenues	XXX	(810,000)
Total revenues	XXX	$1,405,753
Hospital and Medical		
Hospital/medical benefits	$134,857	$1,999,233
Other professional services		13,361
Outside referrals	87,877	87,877
Emergency room and out-of-area	33,322	224,508
Prescription drugs		477,103
Subtotal	$256,056	$2,802,082
Less:		
Net reinsurance recoveries		259,972
Total hospital and medical	$256,056	$2,542,110
Claims adjustment expenses	87,599	87,599
General administrative expenses	157,013	157,013
Total underwriting deductions	$500,668	$2,786,722
Net underwriting loss	XXX	($1,380,969)
Net investment income earned		$121,040
Net realized capital losses		(28,446)
Net investment gains	$0	$92,594
Net income before federal income taxes	XXX	($1,288,375)
Federal income taxes incurred	XXX	(251,985)
Net income	XXX	($1,036,390)

RECONCILIATION OF CAPITAL AND SURPLUS

	2006	2007	2008
Capital and surplus prior reporting year	$2,366,467	$2,696,083	$2,404,676
GAINS AND LOSSES TO CAPITAL AND SURPLUS			
Net income (loss)	$322,997	($291,066)	($1,036,390)
Change in net deferred income tax	(4,110)	(772)	290,247
Change in nonadmitted assets	10,729	432	(559,033)
Paid in surplus			2,000,000
Aggregate write-ins for losses in surplus			(911)
Net change in capital and surplus	$329,616	($291,406)	$693,913
Capital and surplus end of reporting year	$2,696,083	$2,404,677	$3,098,589

CASH FLOW

Cash from Operations

Premiums collected net of reinsurance	$2,146,298
Net investment income	143,271
Total	$2,289,569
Benefit and loss related payments	$2,332,075
Commissions, expenses paid and aggregate write-ins for deductions	242,662
Federal income taxes paid	(100,750)
Total	$2,473,987
Net cash from operations	($184,418)

Cash from Investments

Proceeds from investments sold, matured or repaid:	
Bonds	$1,093,690
Total investment proceeds	$1,093,690
Cost of investments acquired (long-term only):	
Bonds	$374,933
Total investment acquired	$374,933
Net cash from investments	$718,757

Cash from Financing and Miscellaneous Sources

Cash provided (applied):	
Paid in surplus	$2,000,000
Other cash applied	(31,370)
Net cash from financing and miscellaneous sources	$1,968,630

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Net change in cash and short-term investments	$2,502,969
Cash and short-term investments:	
Beginning of the year	422,337
End of the year	$2,925,306

EXAMINERS' CHANGES IN CAPITAL AND SURPLUS

	Corporation	Examiners	Increase (Decrease)
Assets:			
Net deferred tax asset	$9,634	$0	($9,634)
Category 2 investments in excess of Code of Virginia § 38.2-1403	0	257,401	(257,401)
Examiners' decrease in capital and surplus			($267,035)
Total capital and surplus per Corporation			$3,365,624
Total capital and surplus per Examiners			3,098,589
Net decrease in capital and surplus			($267,035)

RECOMMENDATIONS FOR CORRECTIVE ACTION

Accounts and Records

1. Net deferred tax asset $0

The above asset is $9,634 less than the amount reported by the Corporation in its 2008 Annual Statement. The decrease is a result of the Examiners nonadmitting the Net deferred tax asset that the Corporation had admitted pursuant to SSAP No. 10 - Income Taxes. Paragraph 10 b.i. of SSAP No. 10 states that deferred tax assets (DTA) shall be admitted in an amount "expected to be realized within one year of the balance sheet date." However, Section 8.3 of Exhibit A of SSAP No. 10 (Implementation Questions and Answers) states, "The amount of admitted DTAs under paragraph 10 b.i. is limited to the amount that the reporting entity expects to realize within one year of the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the following year cannot admit a DTA related to the loss under paragraph 10 b., even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to the tax allocation agreement."

The Corporation is a member of the consolidated federal income tax return of its ultimate parent, CareFirst, Inc. On a separate company basis, the Corporation has projected a taxable loss for 2009. Therefore, according to Section 8.3 of Exhibit A of SSAP No. 10, the Corporation cannot admit a DTA pursuant to SSAP No. 10, paragraph 10 b i at December 31, 2008.

2. Category 2 Assets in Excess of Amounts Allowable Pursuant to §38.2-1403 of the Code of Virginia $257,401

Code of Virginia § 38.2-1403 states, "The value of Category 2 investments shall be excluded from the value of admitted assets to the extent the value of Category 2 investments exceeds 75% of the amount by which an insurer's surplus to policyholders exceeds its minimum capital and surplus." The Examiners have decreased admitted assets $257,401, which is the amount of Category 2 investments that exceed the available threshold allowed by § 38.2-1403 of the Code of Virginia. Category 2 treatment was accorded to a government agency bond, two money market mutual fund investments and a mortgage pass-through security held by the Corporation. The government agency bond reported by the Corporation exceeded 10% of admitted assets in an agency or instrumentality of the United States pursuant to § 38.2-1413 A 6. The money market mutual fund investments exceeded 10% of admitted assets in a single obligor pursuant to § 38.2-1413 A 7 of the Code of Virginia. The mortgage pass-through security exceeded 2% of admitted assets in a single pool of mortgage pass-through securities pursuant to § 38.2-1437.1 3. The calculation of the excess Category 2 investments is as follows:

a. Net worth as reported in the 2008 Annual Statement	$3,365,624
b. Minimum net worth requirement	600,000
c. Balance available for Category 2 investments ({a-b} x 75%)	$2,074,218
d. Investment in a government agency bond in excess of 10% of admitted assets in agency or instrumentality of United States (§ 38.2-1413 A 6 of the Code of Virginia)	76,192
e. Investment in two money market mutual funds in excess of 10% of admitted assets in one obligor when the investment is classified as cash, cash equivalent, or short-term investment by the NAIC (§ 38.2-1413 A 7 of the Code of Virginia)	2,021,581
f. Investment in mortgage pass-through securities in excess of 2% of admitted assets in a single pool of mortgage pass-through securities. (§ 38.2-1437.1 3 of the Code of Virginia)	233,846
Category 2 investments in excess of amount allowed by § 38.2-1403 of the Code of Virginia (c-d-e-f)	($257,401)

A review of the Corporation's 2008 Analysis of Excess Capital and Surplus Investments Exhibit revealed that the Corporation did include its investments in the government agency bond, the two money market mutual funds and the mortgage pass-through security in its calculation of excess Category 2 assets. However, the Corporation failed to reduce its admitted assets by the amount of excess Category 2 investments as required by § 38.2-1403 of the Code of Virginia. It is therefore recommended that the Corporation reduce its admitted assets by the amount of excess Category 2 investments as required by § 38.2-1403 of the Code of Virginia.

SUBSEQUENT EVENT

At July 31, 2009, the Corporation's enrollment had decreased to 166 members. The Corporation is no longer soliciting new membership. The Corporation has represented that once membership decreases to zero it will cease operations.

CONCLUSION

The courteous cooperation extended by the Corporation's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Ken Campbell, CFE, and Milton Parker participated in the work of the examination.

Respectfully submitted,

Cliff Lewis

Cliff Lewis, CFE
Senior Insurance Examiner

William V. Stack
Vice President and
Corporate Controller

CareFirst BlueCross BlueShield
10455 Mill Run Circle
Owings Mills, MD 21117-4208
Tel. 410-998-7011
Fax 410-998-6850
Cellular 410-218-6634
E-mail: Bill.Stack@carefirst.com

STATE CORPORATION COMMISSION
BUREAU OF INSURANCE
09 NOV 13 AM 9:08

CareFirst.
BlueCross BlueShield

October 30, 2009

Dave Smith
Chief Financial Examiner
State Corporation Commission
Bureau of Insurance
P.O. Box 1157
Richmond, Virginia 23218

Dear Mr. Smith:

We would like to thank you for the opportunity to respond to your financial examination report of CapitalCare, Inc. (CapCare) as of December 31, 2008. We have responded to certain notes and to all of the comments and recommendations in the report by including the text from the report followed by our comments.

Comments and Recommendations:

Accounts and Records

1. Net deferred tax asset $0

The above asset is $9,634 less than the amount reported by the Corporation in its 2008 Annual Statement. The decrease is a result of the Examiners non-admitting the Net deferred tax asset that the Corporation had admitted pursuant to SSAP No. 10 – Income Taxes, paragraph 10 b i. SSAP No. 10, paragraph 10 b i, states, that deferred tax assets (DTA) shall be admitted in the amount "...expected to be realized within one year of the balance sheet date." However, section 8.3 of the implementation guide to SSAP No. 10, states, "The amount of admitted DTAs under paragraph 10 b i is limited to the amount that the reporting entity expects to realize within one year of the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the following year cannot admit a DTA related to the loss under paragraph 10 b, even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to the tax allocation agreement."

The Corporation is a member of the consolidated federal income tax return of its ultimate parent, CareFirst, Inc. On a separate company basis, the Corporation has projected a taxable loss for 2009. Therefore, according to section 8.3 of the implementation guide to SSAP No. 10, the Corporation cannot admit a DTA pursuant to SSAP No. 10, paragraph 10 b i at December 31, 2008.

CapCare's response: The Company has corrected the issue noted above.

2. Category 2 Assets in Excess of Amounts Allowable Pursuant to Section 38.2-1403 of the Code of Virginia $257,401

Section 38.2-1403 of the Code of Virginia states, "The value of Category 2 investments shall be excluded from the value of admitted assets to the extent the value of Category 2 investments exceeds 75% of the amount by which an insurer's surplus to policyholders exceeds its minimum capital and surplus." The Examiners have decreased admitted assets $257,401, which is the amount of Category 2 investments that exceed the available threshold allowed by Section 38.2-1403 of the Code of Virginia. Category 2 treatment was accorded to a government agency bond, two money market mutual fund investments and a mortgage pass-through security held by the Corporation. The government agency bond reported by the Corporation exceeded 10% of admitted assets in an agency or instrumentality of the United States pursuant to Section 38.2-1413 A 6. The money market mutual fund investments exceeded 10% of admitted assets in a single obligor pursuant to Section 38.2-1413 A 7 of the Code of Virginia. The mortgage pass-through security exceeded 2% of admitted assets in a single pool of mortgage pass-through securities pursuant to Section 38.2-1437.1 3. The calculation of the excess Category 2 investments is as follows:

a. Net worth as reported in the 2008 Annual Statement	$3,365,624
b. Minimum net worth requirement	600,000
c. Balance available for Category 2 investments ({a-b} x 75%)	$2,074,218
d. Investment in a government agency bond in excess of 10% of admitted assets in agency or instrumentality of United States (Section 38.2-1413 A 6 of the Code of Virginia)	76,192
e. Investment in two money market mutual funds in excess of 10% of admitted assets in one obligor when the investment is classified as cash, cash equivalent, or short-term investment by the NAIC (Section 38.2-1413 A 7 of the Code of Virginia)	2,021,581
f. Investment in mortgage pass-through securities in excess of 2% of admitted assets in a single pool of mortgage pass-through securities. (Section 38.2-1437.1 3 of the Code of Virginia)	233,846
Category 2 investments in excess of amount allowed by Section 38.2-1403 of the Code of Virginia (c-d-e-f)	($257,401)

A review of the Corporation's 2008 Analysis of Excess Capital and Surplus Investments Exhibit revealed that the Corporation did include its investments in the government agency bond, the two money market mutual funds and the mortgage pass-through security in its calculation of excess Category 2 assets. However, the Corporation failed to reduce its admitted assets by the amount of excess Category 2 investments as required by Section 38.2-1403 of the Code of Virginia. It is therefore recommended that the Corporation reduce its admitted assets by the amount of excess Category 2 investments as required by Section 38.2-1403 of the Code of Virginia.

CapCare's response: The Company has corrected the issue noted above.

If you have any questions or need additional information, please feel free to contact me at (410) 998-7011.

Sincerely,

William V. Stack
Vice President, Corporate Controller